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FISCAL IMPACT STATEMENT

LS 6640

BILL NUMBER: HB 1104

NOTE PREPARED: Feb 3, 2015

BILL AMENDED: Feb 3, 2015

SUBJECT: State Board of Accounts Examinations.

FIRST AUTHOR: Rep. Lehman

FIRST SPONSOR:

BILL STATUS: 2nd Reading - 1st House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) This bill has the following provisions:

Audit Frequency: The bill permits the State Board of Accounts (SBOA) to determine the frequency with which the SBOA conducts financial examinations based on risk-based criteria approved by the Audit and Financial Reporting Subcommittee of the Legislative Council.

Opt Out: The bill provides a procedure for a public entity (other than a school corporation) that has an internal control officer and an internal control department to have examinations performed by a certified public accountant instead of the SBOA.

It adds provisions for allowing a public entity to have an examination:

- (1) conducted outside the time frame provided for by statute or SBOA guidelines, due to federal requirements, continuing disclosure requirements, or as a condition of a public bond issuance; or
- (2) conducted in accordance with Generally Accepted Accounting Principles.

Confidentiality: The bill provides that the results of an examination of the SBOA are confidential until approved and released for publication by the State Examiner. However, it permits disclosure under certain circumstances.

Sheriff's Merit Board: It prohibits a relative of: (1) an active county police officer; or (2) the sheriff; from serving as a member of the sheriff's merit board.

Effective Date: July 1, 2015.

Summary of NET State Impact: (Revised) The bill is expected to have minimal increased cost for the SBOA to develop an audit schedule based on risk-based criteria rather than statutorily enacted time intervals. Additionally, the bill may reduce the workload of the SBOA to the extent that an audited entity opts out of an SBOA audit, and instead hires a certified public accountant (CPA) to perform the audit. However, the number of entities that would qualify under the conditions set for opting out is expected to be minimal.

The SBOA potentially would have more audits based on Generally Accepted Accounting Principals (GAAP) under the bill. This may increase costs for the SBOA to train and maintain staff capable of performing GAAP-based examinations.

Two Class A infractions concerning knowingly or intentionally disclosing information would provide additional revenue to the state General Fund and some dedicated funds if infraction judgements are ordered.

Explanation of State Expenditures: The bill may allow the SBOA to manage its workload by allowing the SBOA to set an audit schedule based on risk-based criteria and by removing statutory time requirements for audit. The process may minimally increase the workload for the SBOA to prepare, maintain, and apply risk-based criteria and receive approval from the Audit and Financial Reporting Subcommittee of the Legislative Council. The application of risk-based criteria to the SBOA's audit schedule is expected to have minimal fiscal impact on the SBOA's resource needs.

The bill could increase workload for the SBOA to provide a second exit conference upon the request of at least two-thirds of the legislative body of a municipality or entity examined. However, the municipality or entity must pay the travel and staff costs of the SBOA.

Additionally, by stating that the exit conference is not a meeting for purposes of the Open Door Law and including more officials in the initial exit conference, the bill may minimize the need for additional meetings with the SBOA.

(Revised) **Additional Information: Risk-Based Audit:** Under state law, the SBOA is responsible for audit of the state, local units, school corporations, and quasi-governmental entities. Entities receiving federal awards with expenditures over \$500,000 must be audited on an annual basis. However, Indiana is allowed to perform biennial audits of federal award recipients because state laws in place on January 1, 1987, require less frequent audits.

The SBOA, in its enabling statute, is required to annually audit the state, cities, counties, towns with a population greater than 5,000, and public hospitals, and biennially audit other municipalities and entities. Additionally, many state statutes enabling state and local entities require audits at certain intervals or on specific dates. The bill would remove the specific times for many audits, while maintaining the annual audit of state government and units that receive federal funds or have bond issues that require annual audit. The exemption that allows school corporations to be audited biennially is maintained. Under the bill the SBOA would be allowed to develop its audit schedule using risk-based criteria with a requirement that every entity is audited at least every four years.

The SBOA receives \$45 per day per field examiner from taxing units and full costs from nontaxing units.

The estimated cost to the SBOA per day per field examiner is \$640. The SBOA issued about 1,586 audits and examinations in 2013.

Risk-Based Criteria: Generally Accepted Government Auditing Standards (GAGAS) require risk-based auditing to provide a high-level of assurance to the financial statement user and to discover material misstatements due to fraud or error. To apply risk-based criteria for auditing, the auditor must understand the audit entity and its internal controls to assess the risk of material misstatement in the entity's financial statements.

(Revised) *Opt Out:* The bill allows an audited entity with an internal control officer and an internal control department to opt out of an SBOA audit and establish a contract with an independent CPA for audit services. The SBOA is to respond to a written request to opt out within 60 days of receiving the request. The contract is to require the CPA to report any fraud, abuse, or crime to the SBOA. The SBOA is to receive the examination report at the same time as the audited entity and not 30 days after the completion of the examination. The workpapers of the CPA are to be available to the SBOA.

If the CPA fails to provide a satisfactory examination, the SBOA is to perform the examination and be reimbursed its actual and direct costs by the audited entity.

(Revised) *GAAP-Based Examinations:* If an audited entity requested a GAAP-based examination, the SBOA would have to approve or disapprove the request within 60 days of receiving the request. The SBOA would have to approve the request, unless one of five conditions exists. These conditions include the timing of the request and accounting practices of the audited entity.

Explanation of State Revenues: *Class A Infractions:* A public agency, employee, or official, or the employee or officer of a contractor or subcontractor who knowingly or intentionally communicates knowledge of the confidential results of an examination or exit interview, except in certain circumstances, commits a Class A infraction. Also, the bill would establish a Class A infraction that would apply to other people who disclose confidential information. If additional court cases occur and infraction judgments and court fees are collected, revenue to the state General Fund may increase. The maximum judgment for a Class A infraction is \$10,000, which is deposited in the state General Fund.

If court actions are filed and a judgment is entered, a court fee of \$70 would be assessed, 70% of which would be deposited in the state General Fund if the case is filed in a court of record or 55% if the case is filed in a city or town court. In addition, revenue from the automated record keeping fee (\$5) is deposited into the state user fee fund, and the judicial salaries fee (\$20), public defense administration fee (\$5), court administration fee (\$5), judicial insurance adjustment fee (\$1), and the DNA sample processing fee (\$2) are deposited into the state General Fund.

Explanation of Local Expenditures: *Schedule:* Local units that are examined less frequently will have reduced examination costs. Any reduction would depend on the rules adopted by the SBOA and the internal controls of the entity.

(Revised) *Opt Out:* An entity that is allowed to opt out of an examination performed by the SBOA may incur additional costs to select and negotiate a contract with a CPA, and may pay more for CPA-contracted services than would have been paid to the SBOA. The entity is to form an uncompensated audit committee to recommend CPA firms to the legislative body of the entity. The legislative body is to select from among the

recommended CPAs and contract with the highest quality CPA, unless cost has been specified as a criteria of selection. The terms of the contract to be negotiated are specified in the bill.

Second Exit Conference: If the legislative body a municipality or entity examined asks for a second exit conference, the municipality or entity will pay for the SBOA's travel and staff costs.

Prosecutor: To the extent that the SBOA's current process is to work with prosecutors on criminal matters involving local officials, no change is expected. [Current law requires the State Examiner to report to the grand jury, but these are no longer convened.]

Explanation of Local Revenues: *Class A Infractions:* If additional court actions are filed and a judgment is entered, local governments would receive revenue from the following sources. The county general fund would receive 27% of the \$70 court fee that is assessed in a court of record. Cities and towns maintaining a law enforcement agency that prosecutes at least 50% of its ordinance violations in a court of record may receive 3% of court fees. If the case is filed in a city or town court, 20% of the court fee would be deposited in the county general fund and 25% would be deposited in the city or town general fund. Persons found guilty of an infraction are also required to pay the following fees that are deposited in local funds: the document storage fee (\$2), which is deposited into the clerk record perpetuation fund, and the jury fee (\$2) and law enforcement continuing education fee (\$4), which are both deposited in the county user fee fund.

State Agencies Affected: SBOA.

Local Agencies Affected: Trial courts, local law enforcement agencies, audited entities.

Information Sources: A133 Circular; State Examiner testimony to the State Audit Committee, August 18, 2014, telephone conversation with Paul Joyce, State Examiner, on October 30, 2014. <https://www.comptroller.tn.gov/audit/AuditManual2011/APPENDIXB%20Fraud%20Risk.pdf>, SBOA Budget Transmittal Letter to Brian Bailey, presented to the Budget Committee on November 20, 2014.

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